Nos. 03-892 AND 03-907

AUG 17 2004

In The
Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

JOHN W. BANKS, II,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

SIGITAS J. BANAITIS,

Respondent.

On Writs Of Certiorari
To The United States Courts Of Appeals
For The Sixth And Ninth Circuits

BRIEF OF *AMICUS CURIAE*, OREGON TRIAL LAWYERS ASSOCIATION, IN SUPPORT OF RESPONDENT, SIGITAS J. BANAITIS

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BRIEF OF *AMICUS CURIAE* OREGON TRIAL LAWYERS ASSOCIATION

I. INTEREST OF *AMICUS CURIAE*.

The Oregon Trial Lawyer's Association (OTLA)[1] offers this brief as *amicus curiae* in support of the respondent taxpayer, Sigitas J. Banaitis ("Banaitis").

OTLA is a statewide organization of over 1,000 trial lawyers, and 200 non-attorneys, dedicated to the preservation of the civil justice system. Its attorney members represent plaintiffs, consumers, investors, small businesses, employees, and parties in state and federal courts in the State of Oregon. OTLA members are frequently compensated on a contingent fee basis, not only in personal injury cases (which are unaffected by Alternative Minimum Tax (AMT)), but also in a wide variety of cases where AMT directly comes into play for an individual taxpayer: cases brought to vindicate employee rights under Oregon common law and discrimination statutes, consumer rights cases, cases for economic injury for homeowners, insureds and investors brought under hundreds of state statutory fee-shifting statutes, contract claims providing for the prevailing party to recover attorney fees, and in split-recovery cases, such as punitive damage claims, where litigants act as private attorneys general for the financial benefit of the State of Oregon.

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[1] In accordance with Rule 33.6, counsel for the Oregon Trial Lawyer's Association is the sole author of this brief, is a past president of the Association, and serves on its *amicus* committee. No monetary compensation was paid for the preparation of this brief other than the volunteer time and cost of printing provided by the brief's author on behalf of the Association.

OTLA has provided the Oregon appellate courts, sometimes at the court's request, with dozens, and perhaps as many as one hundred briefs as *amicus curiae* to assist the court in analyzing and articulating a correct rule of law in civil cases, including *Potter v. Schlesser,* 335 Or. 209, 63 P.3d 1172 (Or. 2003). *Potter* is the Oregon Supreme Court decision upon which the Ninth Circuit relied in reaching its decision on behalf of Banaitis.

OTLA seeks to bring to the attention of this Court relevant matters not already brought to it by the parties concerning attorneys' lien rights in Oregon, and the Oregon Rules of Professional Conduct, which set forth the economic relationship between attorney and client. Simply put: the Commissioner's proposed rule of law is based upon an incorrect interpretation of Oregon law. OTLA members have a keen interest to ensure that this Court does not misinterpret Oregon law. And an incorrect application of Oregon law in this case would have a draconian impact upon Oregon litigants.

II. SUMMARY OF THE ARGUMENT.

The Oregon Legislature has enacted an attorney lien law that expressly provides that an attorney has a charging lien upon a client's cause of action. An attorney lien is a statutory right that expressly provides an attorney with a direct ownership interest in litigation that results from the fruit of their labor in creating a judgment or settlement on behalf of a client, and differs from a mere contractual assignment of income. The Oregon Supreme Court has adopted Rules of Professional Conduct that permits an attorney to acquire an ownership interest in their client's claim only when a reasonable contingent fee has been

agreed upon in civil litigation. Therefore, under Oregon property law, attorney's fees paid to an attorney under a contingent fee that is subject to an attorney's lien is not part of the client's income.

III. ARGUMENT.

The Commissioner, in Section II B, of its brief asserts that the Ninth Circuit misapplied Oregon law, arguing that "[t]he non-proprietary nature" of Oregon's attorney's lien statute results in no direct property rights in their client's litigation when attorneys are hired on a contingent fee basis. The Commissioner's conclusion, and the very premise of its argument, is wrong.

It is a well-established principal of tax law that the property rights of a taxpayer is defined by the laws of each state, and then the federal tax laws uniformly tax those property rights. As a general rule, the existence and nature of property rights and ownership interests are questions of state law. *Aronson v. Commissioner,* 98 T.C. 283, 288 (1992) ("State law creates interests and rights; federal law determines what interests and rights shall be taxed") *citing Morgan v. Commissioner,* 309 U.S. 78, 80 (1940); *Lyeth v. Hoey,* 305 U.S. 188, 193 (1938); *Heiner v. Mellon,* 304 U.S. 271, 279 (1938); *Burnet v. Harmen,* 287 U.S. 103, 110 (1932).

The Ninth Circuit reached the correct conclusion concerning Oregon law based upon the Oregon Supreme Court decision in *Potter v. Schlesser, supra. Potter* concerned the appropriate remedies available to an Oregon attorney under the state's attorney lien statutes. The foundation for the *Potter* decision is founded upon a convergence of two sources: the nature of attorney's lien

statutes in Oregon, and the nature of the ethical rules governing the attorney-client relationship under Oregon law.

A. The Nature of an Oregon Attorney's Lien.

Contrary to the Commissioner's brief at page 39, under Oregon law an attorney's interest in her client's cause of action is not that of a mere "lienor," and an attorney's lien does not arise from an "assignment of client income."

1. An Attorney's Charging Lien Attaches Upon Commencement of the Action.

Attachment of an attorney's lien in Oregon is and has always been based on the direct interest of an attorney in her client's litigation arising from the attorney's "charging lien." An attorney representing a client who has commenced litigation has long possessed a "charging lien" upon her client's cause of action, which necessarily provides the attorney with a property interest in the litigation itself under Oregon law.

Before Oregon's first statutory code, the Deady Code, was enacted in 1862, Oregon recognized the common law right of an attorney to enforce a charging lien against her client's action, judgment and settlement. *Day v. Larsen*, 30 Or. 247, 248 47 Pac. 101 (Or. 1896) ("The right to acquire the lien is a privilege of which the attorney may avail himself . . . "). English courts recognized an attorney's charging lien as an equitable right of an attorney to be paid directly out of the judgment entered on behalf of a client. *Welch v. Hole,* 1 Doug. 238, 99 Eng. Rep. 155 (1779) (Lord Mansfield). Charging liens were well known during colonial times. *See generally,* Note, *Attorney's Liens: A*

Practical Overview, 6 Bridgeport L. Rev. 77, 82 (1985) (briefly describing the two hundred year history of attorneys' liens in England and in the colonial United States).

A charging lien differs from an attorney's retaining lien because it does not depend upon possession. R. Rossi, *Attorney Fees*, §12:13 at p.12-22 (West 3rd Ed. 2001) (hereafter "Rossi"). "An attorney's charging lien, it has been said, is a peculiar lien, and is not like any other lien known to the law." *Id.* The term "lien" is somewhat of a misnomer with respect to attorneys' liens because a true lien at common law required possession of another's property, but an attorney's charging lien, on the other hand:

> "is the equitable right of an attorney to have his fees and charges for costs advanced for services in a particular suit, secured by the judgment or recovery in the suit or action in which the attorney's services were rendered. It is based upon equitable considerations and differs from ordinary liens in that possession is not essential."

Crawford v. Crane, 204 Or. 60, 62, 282 P.2d 348, 349 (Or. 1955).

Rossi, clearly the leading treatise, has noted that the charging lien was created under the common law "for the protection of attorneys against the knavery of their clients," and " . . . is upheld on the theory that the attorney's services and skill produced the judgment . . . " Rossi at §12:13 at p.12-23. "If the attorney's work produces no fruit, the attorney has no lien." *Id.* at §12:27 at p.12-43.

Liens and assignments are two different animals. As the Oregon Supreme Court noted in *Potter v. Schlesser*, "[a]ccording to its dictionary definition, a 'lien' denotes a

'charge upon real or personal property for the satisfaction of some debt or duty ordinarily arising by operation of law' or 'a right in one to control or to hold and retain or enforce a charge against the property of another until some claim of the former is paid or satisfied[.]'" *Webster's Third New Int'l. Dictionary* 1306 (Unabridged Ed. 1993). An "assignment," on the other hand, is "a transfer or making over to another of the whole of any property . . . " *Black's Law Dictionary*, p.1097 (5th Ed. 1979). An attorney who represents a client in litigation, and whose labors results in a judgment, does not receive a "transfer" of the client's interest in the judgment; she creates the client's judgment from the fruit of her own labor.

In 1862 Oregon enacted the Deady Code, which replaced the common law with respect to the nature and extent of an attorney's charging lien. *Day v. Larsen*, *supra*. The Code provided that "an attorney has a lien for his compensation, whether specially agreed upon or implied, . . . upon a judgment or decree, to the extent of the costs included therein, or if there be a special agreement, to the extent of the compensation specially agreed upon . . . " M.Deady & L.Lane, General Laws of Oregon 1843-1872, §1012 (1874) (enacted 10/11/1862). In the presence of a statute creating the lien "upon the cause of action," the lien attaches "to the proceeds of a judgment obtained by the attorney, and in some circumstances to the proceeds of a settlement," and only *in the absence of a statute* does a charging lien operate as an equitable assignment. *Rossi* at §12:27 at p.12-43-44.

In 1939, Oregon revised its attorney's lien statutes based upon Georgia law, and in 1975 made its most recent revisions to Oregon law. *See Ohle, W., Oregon's Attorneys' Liens*, 27 Will.L.Rev. 89, 893 (1991). In 1975 Oregon Laws

chapter 648, the legislature rewrote Oregon's laws regarding all forms of liens, including possessory and non-possessory chattel liens, liens on real property, *and* attorney's liens. These provisions are now found in ORS 87.142 to 87.490. The 1975 amendments repealed ORS 87.495, which provided for charging liens by attorneys without specifying a specific remedy. The provisions of *former* ORS 87.495 are now set forth virtually *verbatim* in ORS 87.445, 87.480, and 87.430. Oregon law presently provides that an attorney obtains a charging lien in one of three ways:

First, an attorney obtains a charging lien upon the action by statute under ORS 87.455[2] when she "commences" an action, suit or proceeding on behalf of her client. Second, the charging lien extends to and is upon the judgments, orders and awards "entered therein" in favor of her client pursuant to ORS 87.445. Third, an attorney obtains a charging lien upon any "settlement between the parties" before or after judgment by virtue of ORS 87.475(1).[3]

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[2] ORS 87.445 provides: "An attorney has a lien upon actions, suits and proceedings after the commencement thereof, and judgments, decrees, orders and awards entered therein in the client's favor and the proceeds thereof to the extent of fees and compensation specially agreed upon with the client, or if there is no agreement, for the reasonable value of the services of the attorney."

[3] ORS 87.475 provides:

> (1) Except as provided in subsections (3) and (4) of this section, the lien created by ORS 87.445 is not affected by a settlement between the parties to the action, suit or proceeding before or after judgment, decree, order or award.
>
> (2) Except as provided in subsections (3) and (4) of this section, a party to the action, suit or proceeding, or any other person, does not have the right to satisfy the lien created by ORS 87.445 or any judgment, decree, order or award

(Continued on following page)

The lien extends to the "fees and compensation specifically agreed upon with the client, or if there is no agreement, for the reasonable value of the services of the attorney." ORS 87.445; *See Rossi* §12:15-12:16.

Although Oregon attorneys "have the same right and power over actions, suits, proceedings, judgments, orders, and awards, to enforce their liens as their clients have for the amount due to them," until *Potter v. Schlesser, supra,* the Oregon Supreme Court struggled with the manner of enforcement of a charging lien. Indeed, until *Potter,* Oregon courts had never affirmed any method for enforcement of an attorneys' charging lien.

In *Jackson v. Stearns,* 48 Or. 25, 29, 84 Pac. 798, 800 (Or. 1906), the court suggested that Oregon law allowed an attorney to continue the cause of action over her client's objection, if the attorney could show that the parties in the litigation had intentionally settled the case to defraud the attorney of her fees.

An attorney whose lien has attached may apply to the court to set aside any disposition of the litigation or settlement, such as setting aside any satisfaction given by

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entered in the action, suit or proceeding until the lien, and claim of the attorney for fees based thereon, is satisfied in full.

(3) A judgment debtor may pay the full amount of a judgment or decree into court and the clerk of the court shall thereupon fully satisfy the judgment or decree on the record and the judgment debtor shall be thereby released from any further claims thereunder.

(4) If more than one attorney appears of record for a litigant, the satisfaction of the lien created by ORS 87.445 by any one of the attorneys is conclusive evidence that the lien is fully satisfied.

the client or reinstating any judgment of dismissal. *Rossi* §12:35. This remedy – continuation of the client's action – has survived since the common law and has been known since the times of Lord Mansfield, but "is not particularly favored by the courts." *Rossi* §12:36 at p.12-55.

Twenty-seven years later, Oregon held that an attorney employed on a contingent fee basis who lost at a trial could not pursue an appeal over her client's objections. *In re Grimes,* 170 Or. 204, 131 P.2d 448 (Or. 1943). *See Rossi* §12:39.

In *Adams v. Transamerica Insurance Group,* 45 Or. App. 769, 609 P.2d 834 (Or. 1980) the Oregon Court of Appeals held that an attorney lacked standing to take action in conflict with the wishes of a former client to overturn a workers compensation award, which set aside a settlement, that would have provided for the attorney's fee. Subsequently the Oregon Supreme Court held that Adams' effort to enforce his attorney's lien violated a Disciplinary Rule of the court that prohibited an attorney from intentionally prejudicing or damaging the client during the course of the professional relationship. *In re Conduct of Adams,* 293 Or. 727, 652 P.2d 787 (Or. 1982). Thus, continuation of the litigation, while permitted at law as a remedy for payment of an attorney's lien, carried with it the risk of disbarment or suspension unless the attorney sought to enforce the lien after termination of the professional relationship. "Under certain circumstances, an attorney's assertion of a lien may constitute a violation of an ethical code or rules governing professional conduct." *Rossi* §12:2 at p.12-5.

In *Crawford v. Crane*, 204 Or. 60, 65, 282 P.2d 348 (Or. 1955), the Oregon Supreme Court held that a summary proceeding for foreclosure was not the proper method for

resolution of an attorney's charging lien.[4] *Crawford, in dicta*, commented that:

> Generally speaking, in the absence of statutory direction there is no well-settled method for the enforcement of either a retaining lien or a charging lien. The methods for the enforcement of each kind are different and for each vary in different jurisdictions. [citing CJS] * * * No statutory method has been provided in this state for the enforcement of a charging lien, as such. * * *

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[4] At the time of the *Crawford* decision, §67-1601 OCLA provided in relevant part:

> "An attorney has a lien for his compensation, whether specially agreed upon or implied, as provided in this section: . . . (2) Upon actions, suits and proceedings after the commencement thereof, and judgments, decrees, orders and awards entered therein in his client's favor and the proceeds thereof in whatsoever hands they may be or come to the extent of the fees and compensation specially agreed upon with his client, . . . and *such lien shall not be affected by any settlement between the parties to the action, suit or proceeding before* or after *judgment*, decree, order or award." (Emphasis added)

Although the legislature has since fundamentally amended the statute, the operative language is still virtually identical. ORS 87.445 provides:

> "*An attorney has a lien upon actions*, suits and proceedings *after the commencement thereof*, and judgments, decrees, orders and awards entered therein in the client's favor *and the proceeds thereof* to the extent of fees and compensation specially agreed upon with the client. . . ." (Emphasis added)

ORS 87.475 provides:

> "Except as provided in subsections (3) and (4) of this section, *the lien created by ORS 87.445 is not affected by a settlement between the parties to the action, suit or proceeding before or after judgment decree, order or award. Subsections (3) and (4) are irrelevant to this case.*" (Emphasis added)

> The provisions of these two sections [*former* OCLA 47-516 & 47-517; *currently* ORS 9.360 & 9.370] provide the only statutory method for securing judicial attention and subsequent enforcement of a retention lien claimed under §67-1601, O.C.L.A. However, they do not supply a remedy or method for the enforcement of an attorney's charging lien, the character of the Hughes lien.
>
> We do not here undertake to say what methods are available to appellant for the enforcement of his charging lien, nor do the exigencies of this appeal demand that we do so. The kinds of relief that might be available, as we have earlier indicated, are not settled but are various and are apparently, in the absence of statutory direction, controlled by peculiar circumstances attending the character of the lien asserted, that is, for example, whether the amount claimed is fixed and determined, unliquidated or contingent, or whether the claim rests upon asserted reasonable value in the absence of an express agreement for compensation. * * * [citing CJS] regarding enforcement of a charging lien.

Crawford recognized that equity would enforce the attorney's charging lien depending on the circumstances of each case. The fact that enforcement of a charging lien is "equitable in nature" is in keeping with the "peculiar" nature of this lien. *Rossi* §12:33. *Crawford*, however, did not decide the specific procedure that equity would use, but instead noted that a "suit to foreclosure a lien created by ORS 87.445," was limited only to liens against personal or real property. Indeed, *Crawford* limited its *dicta* to a *retaining* lien, not to a charging lien under ORS 87.445.

Crawford relied on the general principles set forth in *Corpus Juris Secundum*, which stated:

> "Generally speaking, in the absence of statutory direction, there is no well settled method for enforcement, and the manner of enforcement varies in different jurisdictions. * * * The remedy for enforcing the lien may be left to the court, and it is for the court to determine whether the method selected by the attorney is appropriate under all the facts and circumstances." 7A C.J.S. *Attorney & Client* §391.

Concluding that the court below had erroneously relied on the summary procedures for a possessory lien, the Oregon Supreme Court reversed and dismissed the proceeding without prejudice "to such action as either party deems appropriate in the premises." *Crawford*, 282 P.2d at 351-52.

With that background in mind, in *Potter v. Schlesser, supra*, the Oregon Supreme Court held that an attorney may bring a direct action against a defendant who settles with his client without satisfaction of the attorney's lien.

In *Potter*, a client hired an attorney on a contingent fee basis, and thereafter settled directly with the opposing party. The attorney could always have sued his client for breach of the contingent fee agreement and, thereafter, sought to obtain a judgment against his client and then execute upon client assets. The Oregon Court of Appeals, however, first erroneously held that the attorney's lien statutes were "intended to create a *statutory enforcement mechanism* in situations where parties settled an action without discharging an attorney's lien," and rejected the attorney's argument that he had a statutory remedy under ORS 87.445. *Potter v. Schlesser*, 171 Or. App. 646, 655, 17

P.3d 529, 534 (Or.App. 2000). The intermediate court reached its result contrary to the majority rule described in *Rossi* at §12:40.

When *Potter* reached the Oregon Supreme Court, however, it reversed and articulated for the first time in its history, the manner for enforcement of an attorney's charging lien in Oregon when a client breached a contingent fee agreement. It held that the attorney's charging lien provided the lawyer with a direct property interest in his client's litigation, which was impaired when the client and the opposing party directly settled the dispute without satisfaction of the attorney's charging lien "upon the client's action." The court, thus, held that the attorney was entitled to sue the client's former opponent for enforcement of the lien. Indeed, even after the action had been dismissed and compromised directly by the client and the opposing party, and after the proceeds of the settlement had been disbursed to the client, the attorney retained a property interest "in the action," which the opposing party was required to satisfy.

Had the Oregon Supreme Court viewed an attorney's lien as a mere assignment of client income, as opposed to a direct property interest of the attorney, then attorney Potter could not have proceeded directly against the party who had settled directly with Potter's former client. The settling party paid twice. Had an attorney's lien been premised upon a mere assignment, this party would have successfully asserted that the settlement with the attorney's former client released it from liability to the attorney. Because Potter had a direct property interest in the action, judgment and settlement, his remedy was to proceed against the party who was released from liability by the former client.

The decision in *Potter* was not an aberration or departure from the well settled principles of law or the decision of other courts. For, example, it is hornbook law that:

> "After an attorney's lien has attached, the party adverse to his client, with notice of the lien, cannot destroy it by a voluntary settlement of the claim, without the consent or knowledge of the attorney, without becoming personally liable for the value of the lien. As had been said, a party paying a judgment, or the amount of a compromise, knowing it to be charged with an attorney's lien, is bound to retain, and the law conclusively assumes he has retained, a sufficient amount to pay the lien." *Rossi*, at §12:40, p. 12-65.

> "[A] defendant who settles with plaintiff without knowledge or consent of plaintiff's attorney does so at his own risk as to the attorney's lien, especially where a cause of action actually existed between the parties to the cause and there was notice of the attorney's lien." 7A C.J.S. *Attorney & Client* §386.

> "He may, likewise, in a proper case, enforce the lien against an associate attorney, or against defendant in the litigation in which professional services were rendered as the basis of the lien. * * * The lien may also be enforced against persons who have received the proceeds of a judgment or settlement without due regard for the pending lien." 7A C.J.S. *Attorney & Client* §391(b).

In *Northern Pueblo Enterprises v. Montgomery*, 644 P.2d 1036, 1038 (N.M. 1982), the New Mexico Supreme Court remanded for further equitable proceedings to enforce a charging lien:

> " . . . which is defined as an attorney's right 'to recover his fees and money expended on behalf of his client from a fund created by his efforts, and also the right to have the court interfere to prevent payment by the judgment debtor to the creditor in fraud of his right to the same, and also to prevent or set aside assignments or settlements made in fraud of his right.' *Prichard v. Fulmer*, 22 N.M. 134, 140, 159 P. 39, 41 (1916)."

See also Cherpelis v. Cherpelis, 959 P.2d 973, 976 (N.M. App. 1998) (court enforces attorney's charging lien, citing *Prichard, supra*, and noting that "a court of equity has power to meet the problem presented, and to fashion a proper remedy that will meet the result.")

In *Munro v. Munro*, 424 N.W. 2d 16 (Mich. App. 1988), the court enforced an attorney's charging lien against his client's successor attorney, finding that successor attorney knew or should have known of plaintiff's lien:

> "An attorney's lien is not enforceable against a third party unless the third party has actual notice of the lien or unless circumstances known to the third party are such that he should have inquired as to the claim of the attorney."

Id. at 17-18. The successor attorney's remedy "was to withhold that portion of the proceeds which were necessary to satisfy the lien, and thereafter turn over the remaining amount to his client." *Id.* at 18. The court also expressly rejected the successor attorney's argument that the Code of Professional Responsibility created an ethical obligation that required him to turn over the disputed settlement funds to his client, rather than withhold them or interplead them into court pending resolution of the attorney's lien dispute.

In the Matter of Estate of Gutchess, 456 N.Y.S. 249 (A.D. 1982), the New York Supreme Court affirmed a trial court's stay of the distribution of the assets of an estate pending resolution of the former attorney's lien claim, where parties had settled estate litigation with assistance of successor counsel. The lien attached to the claim from the "commencement of an action" and attached to the settlement proceeds even though the matter settled without a final determination of the dispute by the Surrogate's Court. "The fact that the representatives of the two estates reached a settlement does not affect petitioner's lien." *Id.* at 251. The Court affirmed the lower court's stay order by requiring that an amount sufficient to satisfy the attorney's fee lien be withheld from the balance of the estate.

See also *In re De Berry*, 59 B.R. 891 (E.D. N.Y. 1986), (bankruptcy court protects funds distributed to plaintiff's attorney's after settlement of a personal injury claim on behalf of the debtor against claim by trustee. The Court noted that, by statute, the attorney's lien attached "from the commencement of the action" and that "the lien attaches to the proceeds of a settlement the same as it would attach to a judgment.")

In Utah, the court allowed an equitable suit to be filed against both the ex-client and opposing party, but required plaintiff to try to first collect from his ex-client. In *Eastmond v. Earl*, 912 P.2d 994 (Utah 1996), plaintiff's attorney brought his claims for fees against both his former client and her ex-husband to recover on his charging lien. The Utah Court of Appeals affirmed the trial court's summary judgment in favor of the attorney's charging lien against the ex-husband, who had elected to pay sums to the attorney's client despite notice of the attorney's lien.

Although the court noted that the attorney ordinarily must first try to collect from the party receiving the proceeds, in *Eastmond*, the attorney's client had been discharged in bankruptcy during the pendency of the action. *See* also *Lundy v. Cappuccio*, 181 P. 165 (Utah 1919) (Utah Supreme Court remands with instructions that attorneys claiming lien bring proceedings against all potentially liable parties, including garnishers, where debtor paid third party garnishment instead of attorneys' lien on judgment, with enforcement against debtor contingent on inability to collect lien from garnishers).

The nature of an attorney's charging lien differs from other "liens;" it is an equitable right created by the court to protect attorneys and has always provided an attorney with a direct property interest "in the action," to protect the "fruits of the attorney's skill and labor," and directly is a property interest in his or her client's litigation; it is a direct "charge upon the action," and, as such is not a mere "assignment" of client income from the litigation.

2. Written Notice Is Not Required To Perfect A Charging Lien.

Contrary to the Commissioner's brief at page 39, there is no requirement that an attorney perfect the lien by filing written notice. However, the property interest of an attorney, as created by Oregon's lien statutes, may be lost after a specified period of time.

The lien exists so long as the attorney is counsel of record in her client's litigation, and continues for a specified period of time after judgment without any written notice. The charging lien provides all of the protection necessary for an attorney, and the mere fact that a client is

represented by counsel in pending litigation is notice to the world of the existence of the attorney's charging lien.

Filing suit is sufficient notice, and indeed is actual notice of the attorney's lien upon the action. *Rossi* at §12:19 p.12-31. However, in Oregon an attorney will lose her lien unless within a specific period of time after entry of a judgment "for a sum of money" (three years) or judgment for "the possession, award," transfer or conveyance of real property (six months) and personal property (one year), written notice is filed with the clerk of the court or county recorder. ORS 87.465, ORS 87.450(1),[5] 87.455, 87.460.

Moreover, written notice of the lien is prudent practice when an attorney is discharged, or the client changes counsel, because at that juncture, the attorney loses control over the action, ORS 87.480, and the client's new counsel gains the ability to satisfy the discharged attorney's lien, ORS 87.475(4). The reason for written notice of the existence of a direct property interest by a discharged attorney in her client's litigation is readily apparent. An

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[5] (1) When an attorney claims a lien under ORS 87.445, if the judgment or decree is for a sum of money only, the attorney must file a notice of claim of lien with the clerk of the court that issues the judgment or decree within three years after the judgment or decree is given. The clerk shall enter the notice in the records of the action or suit and shall also make a note of the filing of the notice in the judgment docket of the court.

(2) When an attorney files a notice of claim of lien under subsection (1) of this section, the attorney shall send forthwith a copy of the notice to the client by registered or certified mail sent to the client at the last-known address of the client.

(3) A lien under ORS 87.445 on a judgment or decree for a sum of money only remains a lien on that judgment or decree for as long as the judgment or decree remains valid under ORS 18.360 or 18.365.

attorney, like any other party to a contract, has always been able to sue a client who breaches a contract to pay fees. However, after an attorney is discharged, she has lost "the same right and power over actions, suits, proceedings, judgments, decrees, order, and awards to enforce their liens as their clients have." The Commissioner's reliance upon the written notice provisions of Oregon law, thus, do not support the argument that attorney's lack a proprietary interest in their client's litigation.

B. The Nature of a Contingent Fee Agreement in Oregon.

Even when an attorney's lien "upon the action" has not yet attached, such as when an action has not been filed, or when a potential claim is settled before commencement of any suit, action or proceeding, a contingent fee agreement creates an "equitable lien" in the action which, as a practical matter, is identical to an attorney's lien. Some courts have held that "a contract for a contingent fee is deemed to create a *pro tanto* equitable assignment, or to transfer an equitable interest in favor of the attorney in the cause of action or in the proceeds thereof." *Rossi* §2:4 at p.2-10. *Rossi* also notes that the distinction between the contract right of an attorney in contingent fee litigation creating an "assignment," and an attorney's lien created by statute, is "somewhat artificial" and "may turn on semantic differences that do not necessarily correspond to the intentions of the parties."

> "Many jurisdictions have enacted attorneys' fee lien statutes. While the lien statute may provide the only method of obtaining such a lien in some jurisdictions, and the practical value of obtaining an equitable lien has been diminished in other

> jurisdictions because of the statutory remedy, equitable lien principles can often be utilized despite the existence of a lien statute." *Id.* at p.2-13.

The existence of a contingent fee, whether before or after the commencement of litigation, also provides another source for an attorney's direct proprietary interest in her client's litigation.

In Oregon as in many States, an attorney may enter into a contingent fee agreement for compensation in certain cases. As such, an attorney acquires a "proprietary" interest in the client's litigation in Oregon. Disciplinary Rule DR 5-103(A)(2) provides that "[a] lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting, except that the lawyer may: * * * [c]ontract with a client for a reasonable contingent fee in a civil case, subject to the limitations imposed by DR 2-106."

The term "proprietary" has a plain and unambiguous meaning. It means "[b]elonging to ownership; belonging or pertaining to a proprietor, relating to a certain owner or proprietor; made and marketed by a person or persons having the exclusive right to manufacture and sell such; as proprietary article, medicine or food," and "proprietor" means "one who has the exclusive title to a thing; one who possesses or holds the title to a thing in his own right; one who possesses the dominion or ownership of a thing in his own right." *Black's Law Dictionary*, p.1097 (5th Ed. 1979).

At common law, contingent fee agreements were considered champertous, and therefore, illegal. *Rossi* §2:1 at p.204. "Champerty is the intermeddling of a stranger in the litigation of another, for profit, and maintenance is the

financing of such intermeddling." *Groce v. Fidelity General Ins. Co.*, 252 Or. 296, 304-305, 448 P.2d 554, 558 (Or. 1968). In Oregon, champerty resulted when an attorney was "buying up doubtful claims," but an attorney hired on a contingent fee basis did not, strictly speaking, engage in champerty because she did not prosecute litigation in her own name. *See Craig v. Maher,* 158 Or. 40, 47, 74 P.2d 396, 399 (Or. 1937).

Oregon's disciplinary rules concerning contingent fees are substantially similar to Rule 1.8(j) of the Rules of Professional Conduct of the American Bar Association, which provides:

> A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for the client, except that the lawyer may: (1) acquire a lien granted by law to secure the lawyer's fee or expenses. . . .

It is often said that a contingent fee is the "poor man's key to the courthouse door," and is often the only way that the middle class can have their rights vindicated by enabling one with a meritorious cause of action to obtain competent counsel. *See Rossi* §2:3 at p.2-8 fn.1. For most Americans, the contingent fee offered by plaintiff's counsel plays an absolutely essential role in the administration of justice. The Commissioner's misinterpretation of "income" of the taxpayer, as including the attorney fees paid to an attorney under a contingent fee agreement, simply shuts the courthouse doors and excludes individuals in the middle class and the poor from equal access to justice by manipulation of the tax code.

Contingent fee agreements between attorney and client are subject to legislative limits, however. For example in Oregon, contingent fees are prohibited in criminal cases or domestic relations cases. *See* DR 2-106(C). In civil personal injury cases, special protection is provided to clients in order to render enforceable a contingent fee agreement, including plain language requirements, a "model" explanation and a 24-hour rescission period. ORS 20.340. While personal injury judgments and settlements are excluded from an individual's gross income under IRC §104(a)(2), contingent fees agreements are frequently used by plaintiff's attorneys bringing cases to vindicate employee rights under Oregon common law and discrimination statutes, consumer rights cases, cases for economic injury for homeowners, insureds and investors brought under hundreds of state statutory fee-shifting statutes[6],

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[6] A few notable examples of fee-shifting statutes in Oregon include:

- *Wage Claims.* Failure to pay wages or overtime. ORS 652.200. Unequal pay. ORS 652.230.
- *Consumer Protection Statutes.* Consumer entitled to recovery the greater of actual damages or $200, plus attorney fees for unlawful trade practices. ORS 646.638. Unlawful debt collection practices. ORS 646.642. Warranty claims under $2,500. ORS 20.098.
- *Securities Violations.* Purchaser of securities may recover consideration paid for security, plus attorney fees. ORS 59.115(10).
- *Insurance Claims.* Insurance policyholder entitled to recovery of attorney fees against insurer when recovery exceeds amount tendered by insurer in action upon any policy of insurance. ORS 742.061(1).
- *Contract Claims.* In all contract claims, when amount due is less than $5,500, reasonable attorney fees are paid to prevailing party. ORS 20.082. Actions on dishonored checks. ORS 30.701(3).
- *Property Claims.* In all property damage claims, when the amount pled is less than $5,500, attorney fees are paid to prevailing party. ORS 20.080. Trespass or nuisance arising from farming or forest practices. ORS 30.938. Condemnation proceedings. ORS 20.085.

(Continued on following page)

contract claims providing for the prevailing party to recover attorney fees,[7] and in split-recovery cases,[8] such as punitive damage claims, where litigants act as private attorneys general for the financial benefit of the State of Oregon.

In each of these areas, the Oregon Legislature made a decision to provide attorney fees to a prevailing plaintiff is designed to "make whole" a party in litigation. Attorneys representing plaintiffs in fee shifting cases routinely represent the plaintiff on the basis that the court's award of attorney fees will be credited against the contingent fee recovery so that the attorney receives the greater of either the percentage agreed upon in the fee agreement or the court ordered amount of attorney fees. *Chalmers v. Oregon Auto. Ins. Co.*, 263 Or. 449, 454, 502 P.2d 1378, 1381 (Or. 1972).

• *Discrimination Claims.* Discrimination in employment, public accommodation, real property transactions. ORS 659A.885(5)(d); ORS 20.107.

[7] Many but not all of the fee-shifting statutes cited above are reciprocal, and provide attorney fees for the prevailing party. Oregon law also provides that in all contracts that provide attorney fees for enforcement of the contract, the party that prevails on the claim, whether specified in the contract or not, is entitled to reasonable attorney fees. ORS 20.096.

[8] Oregon limits distribution of punitive damages under a "split-recovery" statute under which the Department of Justice of the State of Oregon is paid 60% of all verdicts for punitive damages, ORS 31.735(1)(b) (*former* 18.540(1)(b)). The prevailing party entitled to receive punitive damages is limited to 40%, and the party's attorney "shall be paid out of the amount allocated under this paragraph . . . in no event may more than 20 percent of the amount awarded as punitive damages be paid to the attorney for the prevailing party." ORS 31.735(1)(a) (*formerly* 18.540(1)(a)). *See DeMendoza v. Huffman*, 334 Or. 425, 51 P.3d 1232 (2002).

The Commissioner's proposed rule would have a profound impact upon this "make whole" remedy. The simplest example arises in consumer cases or small wage cases where the plaintiff's taxable compensatory or statutory damages are small. For example, the jury may award, $200, in an Unlawful Trade Practices Act claim, and the court may thereafter award $100,000 to the plaintiff for the recovery of attorney fees. The Commissioner's rule would include the gross recovery, $100,200, in the gross income to the individual taxpayer. Although the taxpayer would pay $100,000 in attorney fees, he or she would also owe AMT $26,000, notwithstanding a compensatory damage award of $200. Thus, the taxpayer would pay $26,000 in AMT for the "privilege" of vindicating the right to receive $200. This absurd result is the direct consequence of the Commissioner's incorrect interpretation of the property interest of attorneys in a contingent fee case, and would destroy the "make whole" remedy, not because of the intended tax impact on the $200 in compensatory damages, but because of the unintended tax impact upon the award of attorney fees.

When the above example is applied to reciprocal attorney fees, the bizarre consequences of the Commissioner's position becomes more stark. A jury may render a verdict against a plaintiff and in favor of an individual defendant who thereafter receives an award of $100,000 in attorney fees from the court. The Commissioner would include the $100,000 awarded to the prevailing defendant in the defendant's gross income. The defendant would thereafter owe $26,000 in AMT for the "privilege" of successfully defending the lawsuit. The defendant is, thus, never, "made whole."

Under a split recovery statute, inclusion of attorney fees in the income of the taxpayer can be even more dramatic. Contrary to its position in *Banaitis*, the Commissioner has determined that a taxpayer is not required to include in gross income the portion of a punitive damage recovery that is rendered to the state pursuant to a split recovery statute. *IRS Chief Counsel Advice C.C.A. #200246003* (The non-binding effect of the C.C.A. on the Commissioner is expressly noted therein and cautions that "it should not be cited as precedent"). The C.C.A. did not permit a deduction for the 60% paid to the State; it determined that this portion of a punitive damage recovery was not included in gross income because the taxpayer "did not have command over the disposition of the portion of the proceeds deemed rendered to the state." However, there is little reason to distinguish between the 60% paid to the State and the 20% paid to the taxpayer's attorney under the split recovery statute. The taxpayer has no more or less a "command" over the disposition of the State's share as he or she does over the attorney's share of a punitive damage recovery. However, a taxpayer, under the Commissioner's proposed rule in this Court, due to its "assignment of income" rationale, would be required to include the State's 60% share in his or her gross income.

The proprietary interest of an attorney in their client's litigation as a result of a contingent fee is a matter wholly within the sovereign authority of the States and, more importantly is central to each State's judicial branch of government. Indeed, this Court has held that "the regulation of the activities of the bar is at the core of the State's power to protect the public." *Bates v. State Bar of Arizona*, 433 U.S. 350, 361, 97 S.Ct. 2691, 2697, 53 L.Ed.2d 810 (1977). *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 792,

95 S.Ct. 2004, 2016, 44 L.Ed.2d 572 (1975) ("The interest of the States in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the courts'.") A State Supreme Court's sovereign authority to define the interests of an attorney in a client's litigation is at "the core of the State's power to protect the public" because few other professions are "essential to the primary governmental function of administering justice." *See In re Griffiths*, 413 U.S. 717, 722-23, 93 S.Ct. 2851, 2855, 37 L.Ed.2d 910 (1973).

The Disciplinary Rules of Oregon are matters entirely within the authority of the Chief Justice of the Oregon Supreme Court as the administrative head of the judicial department. ORS 1.002(1). The Oregon Supreme Court has adopted ethical codes to permit an attorney to gain a proprietary interest in a client's civil action under a reasonable contingent fee agreement. This evidences a compelling state interest concerning the property rights of litigants. That the Oregon legislature has permitted an attorney to obtain a lien "upon the action" of a client, evidences "the legislature's limitation . . . on the court's disciplinary authority . . . [over attorneys]." *In re Conduct of Allen*, 326 Or. 107, 118, 949 P.2d 710 (1997); *Ramstead v. Morgan*, 219 Or. 383, 399, 347 P.2d 594 (1959) (held: the Legislature "may act authoritatively with respect to some matters which affect the judicial process.").

That the Oregon Supreme Court has determined that an attorney may acquire a proprietary interest in her client's litigation only by a reasonable contingent fee in certain civil litigation, is further evidence that Oregon, like many other states, has created an unique ownership interest for attorneys in their client's litigation to protect

the individual's access to justice. The state has a compelling interest in providing attorneys with a proprietary interest in contingent fee litigation that is subject to an attorney's lien.

The Commissioner criticizes the Ninth Circuit for reaching different results within its Circuit, but the court was bound to determine property interests in accordance with the law of the State in which the income was earned.

Of course, the "assignment" of income doctrine, first applied in *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930), was never designed to tax the same income twice, but instead was designed to prevent the shifting of income, often to related parties, family members in lower brackets. In each of these cases, unlike contingent attorney fees, the taxpayer had earned and created the right to receive and enjoy the benefit of the income prior to its assignment. Although some states may follow the "anticipatory assignment of income" doctrine with respect to the property interest of an attorney in a client's recovery, it is apparent that Oregon does not. In the present case, the attorney pays tax on the share of attorney fees earned at the attorney's taxable rate, and the client pays tax on the client's share of the judgment or settlement at the individual taxpayer's rate. The design is not to "shift income," but rather, it is to tax the income of the person who earned it, and not to tax income where it is not created.

Banks v. Commissioner, 345 F.3d 1074 (9th Cir. 2003) provides the most consistent and rational treatment for contingency attorney fees by holding that such fees are not an "assignment of income," and are excludable from gross income by joining in the Fifth Circuit in *Srivastava v. Commissioner*, 220 F.3d 353, 364 (5th Cir. 2000), the Sixth

Circuit in *Estate of Clarks v. United States,* 202 F.3d 854 (6th Cir. 2000) and Eleventh Circuit in *Foster v. United States,* 249 F.3d 1275 (11th Cir. 2001). These cases hold simply that contingent attorney fees are excludable from gross income of the taxpayer. They reach the correct result, and for slightly different reasons than the Ninth Circuit in *Banaitis*, which was reached based upon a state attorney lien law analysis to identify property ownership in litigation. Also *see Cotnam v. Commissioner,* 263 F.2d 119 (5th Cir. 1959). However, if the Court rejects the *Banks* rationale, it cannot thereafter ignore the rationale of *Banaitis* and *Cotnam* that under state law, attorneys have an ownership interest in their client's litigation by virtue of a contingent fee entered into in accordance with the Oregon Supreme Court's Disciplinary Rules, and in litigation subject to the Oregon Legislature's attorney lien statutes.

IV. CONCLUSION.

For each of the reasons set forth above, this Court must recognize the particular proprietary interest that an attorney has in a client's litigation under a contingent fee that is subject to an attorney's lien. The attorney's fees earned by the attorney are the attorney's income; not the client's tax nightmare.

Respectfully submitted,

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